United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

74-2250

No. 74-2250

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 74-2250

THE E. R. HITCHCOCK COMPANY, a corporation

Plaintiff-Appellee

v.

UNITED STATES OF AMERICA

Defendant-Appellant

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES
DISTRICT COURT FOR THE DISTRICT OF CONNECTICUT

BRIEF FOR THE APPELLEE

EDWARD B. SCOTT
CAMP, WILLIAMS and RICHARDSON
130 West Main Street
New Britain, Connecticut 06050
Attorney for the Plaintiff-Appellee

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

TABLE OF AUTHORITIES (Continued)

Cases

Statutes

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 74-2250

THE E. R. HITCHCOCK COMPANY, a corporation

Plaintiff-Appellee

v.

UNITED STATES OF AMERICA,

Defendant-Appellant

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF CONNECTICUT

BRIEF FOR THE APPELLEE

STATEMENT OF THE ISSUE PRESENTED FOR REVIEW

Whether the District Court erred in holding that the entire amount awarded to the taxpayer on the condemnation of its property qualified for non-recognition of capital gain under Section 1033 of the Internal Revenue Code of 1954, even though such award included, as an element of damage, the estimated cost of moving the taxpayer's business to a new location.

SUMMARY OF ARGUMENT

Under the law of Connecticut, as stated by its highest court, an award for the taking of business property containing valuable machinery and equipment belonging to the owner of the real estate, must take into account the cost of moving the machinery and equipment, not as a separate item of damage, but as a factor in computing the fair market value of the property taken. In conformity with the law thus stated, a State Referee made a finding that the cost of moving the taxpayer's machinery and equipment would be $40,000. and that, taking this factor into consideration, the fair market value of the taxpayer's property was $130,000. The Superior Court approved the Referee's report and the award was paid.

The actual moving expenses were $18,940.20, but the Taxpayer treated the full amount of the award as "the amount realized" upon the involuntary conversion and claimed it as nonrecognized capital gain under the provisions of Section 1033 (a)(3)(A) of the Internal Revenue Code. It is not disputed that the Taxpayer did, in fact, expend the entire amount for replacement property qualifying for nonrecognition of capital gain.

The Government insists, however, that, notwithstanding the decisions to the contrary by the Supreme Court of the State, the Taxpayer actually received two awards, an award of $90,000. for the value of its property determined without consideration of moving expenses, and another award of $40,000. as reimbursement for anticipated moving costs. The Government contends that the first award only is to be considered as "the amount realized" from the involuntary conversion, and so to be qualified as nonrecognized Capital gain under Section 1033(a)(3)(A), and the second award, to the extent that it

exceeds the actual cost of moving, is not part of "the amount realized" from the conversion, but is taxable as ordinary income.

The taxpayer contends that the State decisions holding that moving expenses are not a separate item of damages, but are a factor to be considered in computing fair market value, are determinative of the nature of the award; that this determination is not a mere question of nomenclature, but goes to the very substance of the interest created, and the District Court correctly considered it in applying the federal tax law.

The taxpayer further contends that even if the Court should hold that the award is separable into two amounts, that the portion allocated to "moving expenses" is still a part of "the amount realized" upon the involun tary conversion and is entitled to nonrecognition of capital gain under the provisions of Section 1033 (a)(3)(A).

The judgment of the District Court should be affirmed.

ARGUMENT

I

UNDER CONNECTICUT LAW, AS STATED BY THE STATES HIGHEST COURT, THE AWARD IS ENTIRELY COMPENSATION FOR THE TAKING OF PROPERTY AND NO PORTION OF IT IS SEVERABLE AS REIMBURSEMENT FOR MOVING EXPENSES.

The Connecticut statute which describes the procedure for the acquisition of real property by redevelopment agencies, makes no reference to reimbursement for moving expenses. The statutory provision is as follows:

> "The development agency shall determine the compensation to be paid to the persons entitled thereto for the real property and shall file a statement of compensation, containing a description of the property to be taken and the names of all persons having a record interest therein and setting forth the amount of such compensation -------"
>
> Gen. Stat. (1958) Sec. 8-129

The provisions of the statute with respect to an appeal by the owner from the statement of compensation, provide that the Superior Court shall "appoint a referee to make a review of the statement of compensation." The referee is to "hear the applicant and said redevelopment agency","view the property and take such testimony as such referee deems material and shall thereupon revise such statement of compensation in such manner as he deems proper and forthwith report to the Court."

Gen. Stat. (1958) Sec. 8-132

The decisions of the highest court of the State, the Supreme Court of Errors, are explicit in stating that the measure of damages is the fair market value of the property taken. Market value has been defined as "the price that would in all probability ------ the probability being based upon the evidence in the case -----result from fair negotiations, where the seller is willing to sell and the buyer desires to buy."

Sharpe v. United States, 112 Fed. 893 at 898 (C.C.A. 3rd. 1902)

This definition has been repeatedly quoted and accepted by the Connecticut courts

Portland Silk Co. v. Middletown, 125 Conn. 172 at 174
4A(2nd) 422 (1939)

Andrews v. Cox, 127 Conn. 455 at 457-8 17 A(2nd) 507 (1941)

Harvey Textile Co. v Hill, 135 Conn. 686 at 688, 67 A.2d) 851 (1949)

Market value, thus defined, has been held to be the entire matter to be considered. Factors such as the presence on the property of valuable minerals or crops or trees, are to be considered as affecting the market

value of the property, but not as separate items of value in addition to the land. The courts have quoted with approval the following from a well known text.

> "the market value of the land as land remains the test, and there can be no recovery for any of the foregoing elements, valued separately as merchandise as items additional to the value of the land."
>
> 1 Nichols, "Eminent Domain", 2nd Ed. Sec. 226 quoted in
>
> Hollister v. Cox, 131 Conn. 523 at 526, 41 A(2d) 93, 157 ALR 132 (1945)
>
> Harvey Textile Co. v. Hill, 135 Conn. 686 at 689, 67 A(2d) 851 (1949)

In Harvey Textile Co. v Hill, the Court had before it the question of moving expenses as an element of damages where land and a factory building were taken for highway purposes. The State referee found that the property had a vlue of $42,100. but that the cost of disassembling, moving and reassembling the factory machinery would be $5,000. so that if the owner were entitled to moving costs, the damage would be $47,100. The Superior Court entered judgment for the lesser amount. On appeal by the owner, the Supreme Court considered that the question before it was "whether the necessity of removing the machinery legitimately affected the market value of the property."

The Court reasoned, as follows:

> "An owner would demand a higher price for a factory containing complicated and valuable machinery than he would for the same building idle and empty, because he would be faced with the necessity of moving his machinery to save it. His willingness to sell would be affected by this consideration, which would thus enter into the fixing of a fair market

> value. It was therefore the duty of the trier to consider this element in arriving at the fair market value, not as a separate specific sum of money to be added to the value of the land but as evidence tending to prove its fair market value.
>
> Harvey Textile Co. v. Hill, 135 Conn. 686 at 689-90 67 A(2d) 851 (1949) emphasis supplied)

Harvey Textile Co. v. Hill, was a case involving a taking for highway purposes. In Del Vecchio v. New Haven Redevelopment Agency , the Court was faced with the same question with respect to a taking of a bakery by a Redevelopment Agency. The referee found that the value of the land and bakery building was $64,000. but if the cost of moving the machinery were taken into consideration the value of the property would be $66,945. The Superior Court entered judgment for the greater amount. On appeal by the Agency, which urged that Harvey Textile Co. v. Hill should be overruled, the Court, instead, reasserted the rule of that case, and pointed out, with approval, that the referee's alternative award, "was based on a consideration of the cost of moving the machinery, not as a separate and distinct item of damages, but as evidence bearing upon fair market value."

> Del Vecchio v. New Haven Redevelopment Agency, 147 Conn. 362 at 364, 161 A(2d) 190 (1960) Emphasis Supplied)

In the Del Vecchio Case, it was pointed out that the owner did not, in fact, move the bakery machinery to a new location but sold it, and actually paid the moving expenses only because he had agreed to pay them as a condition of the sale. Noting these facts, the Court held that the value was fixed as of the date of the taking, and on the basis of the factors then in existence, the owner was entitled to have moving costs considered as an

element in determining fair market value.

Del Vecchio v. New Haven Redevelopment Agency, 147 Conn. 362 at 365, 161 A(2d) 190 (1960)

If the element of moving expenses were considered to be a separate item of reimbursement of anticipated expense, the Court would probably have considered it differently.

In the case of Stanley Works v. New Britain Redevelopment Agency, the Court had before it the converse of the situation in Del Vecchio. In this case, the Stanley Works, in anticipation of the taking, had moved all of its machinery to a new plant, at a cost of $2,008,206. The move was completed three months prior to the date of taking. If moving expenses were a separate item of damage, the Company would clearly have been entitled to recover this cost because it was occasioned directly by the taking. However, the Supreme Court upheld the referee in refusing to consider this cost as a factor affecting the value of the property at the date of taking, because, on that date, it was not a factor then in existence.

Stanley Works v. New Britain Redevelopment Agency
155 Conn. 86 at 103, 230 A(2d) 9 (1967)

In a case where the referee found that moving costs would amount to $10,171. if the business could be moved, but also found that there was no location or site anywhere in the area, to which a move could be made, the Court, nevertheless, held that moving costs were an element to be considered in determining the value of the property taken.

Seferi v. Ives, 155 Conn. 580, 236 A(2d) 83 (1967)
Appeal Dismissed, 391 U.S. 359, 88 S. Ct. 1665, 20 L. Ed. 2d. 640

Wherever the Supreme Court of Errors has had occasion to discuss the issue, it has uniformly been to reiterate that where a going business is taken by eminent domain, the owner is entitled to just compensation for the taking; that just compensation is fair market value; that fair market value is what a willing seller could obtain from a willing buyer; and that a seller would become a willing seller only if he were to be compensated for the cost of moving his machinery and equipment, and, therefore, the cost of such moving is an element to be considered as affecting the fair market value of the property, but is not the subject of an award separate from and in addition to the value of the property taken.

Hunter Press, Inc. v. Ives, 150 Conn. 32, 183 A(2d) 842 (1962)

See: Eljay Realty Co. v. Argraves, 149 Conn. 203 at 206, 177 A(2d) 677 (1962)

See: Slavitt v. Ives, 163 Conn. 198 at 213, 303 A(2d) 13 (1972)

This is a matter of substance, not nomenclature or labels. If the owner's machinery is on the land at the date of taking, moving expenses are a factor in determining fair market value, whether any actual moving takes place or not. If the machinery is not on the land at the taking date, moving expenses are not a factor, notwithstanding that substantial moving expenses may have been actually incurred in anticipation of the taking. Under these circumstances, to say that Connecticut is awarding reimbursement for moving expenses under the label fair market value, is to depart widely from reality.

II

THE STATE LAW DETERMINES THE NATURE OF THE AWARD FOR FEDERAL TAX PURPOSES.

The nature of the legal interest to be taxed, in this case, the compensation award, is determined by the law of Connecticut, because it was Connecticut law which created and defined the right to receive the award.

> "in the Application of a federal revenue act, State law controls in determining the nature of the legal interest which the taxpayer had in the property or income sought to be reached by the statute."

Morgan v Com'r of Internal Revenue, 309 U.S. 78 at 82, 60 S. Ct. 424, 84 L. Ed. 585 (1940)

In the present case, it is the contention of the Government, that notwithstanding that the State law explicitly declares that moving expenses are not a separate award, nevertheless, for purposes of federal taxation, the State law is to be disregarded and, if the District Director is able to determine what the award would have been, had moving expenses not been considered, he may tax the excess above that amount as ordinary income.

To support this contention, the Government cites decisions in two types of cases, interest cases and severance cases.

The interest cases, of which Kieselbach v. Commissioner, 317 U.S. 399. 63 S. Ct. 303, 87 L. Ed. 358 (1943) is the principal authority, hold that where a condemnation award includes an element of damages for the delay in payment after the date of the taking, whether this element is described as "interest" or "detention damage", "delay damages", or by any other term, the portion of the award so derived is not attributable to the value of the property taken at the time of taking and is not capital gain but ordinary income. This statement of the law is not disputed, but, it is submitted, that it has no application to the present case.

The severance cases deal with the situation where a portion only of a parcel of real estate is taken, and the condemnation award includes compensation for the resulting diminution in value of the portion not taken. This court was confronted with a severance case in Lapham v. United States, 178 F.(2d) 994 (C.A. 2d 1950). In Lapham, the taxpayer, under threat of condemnation, sold a portion of the land to the State of Connecticut. Afterward, she claimed that part of the price was not capital gain because it was attributable to "severance damage" to the portion of her land which she retained. This Court denied her claim, not because the allocation was attempted after the sale, but

> "because what the seller actually received is what he has realized on the disposal of it (the land) by sale."
>
> Lapham v. United States, 178 F(2d) 994 at 996 (C.A. 2d, (1950)

The Government, nevertheless, cites Vaira v. Commissioner, 444 F(2d) 770, (C.A. 3rd. 1971) and Arch B. Johnston v. Commissioner, 42 T.C. 880 (1964). Both of these cases hold that, in a severance case, the taxpayer may, if he can show the amount of the award attributable to the loss in value of the retained property, avoid having this amount included in his capital gain. In neither of the cases had the taxpayer reinvested the proceeds of the award in such a manner as to qualify for nonrecognition of capital gain under Section 1033 (a) (3)(A) of the Code. In each case, therefore, he sought to reduce the amount of his recognized capital gain by the amount attributable to severance damages and in both cases, the Courts decided that he might do so. Neither Vaira nor Johnston dealt with the question whether a taxpayer, having used the entire proceeds of the award to acquire replacement property so as to qualify for nonrecognition of the gain, can be compelled, nevertheless, to pay ordinary

income tax on a portion of the award which is attributable to severance damages. This was the situation in Conran v. United States, 322 F. Supp. 1055 (D.C. E.D. Mo. 1971) and the Court there decided that the taxpayer was entitled to non-recognition of the entire amount of the award. It is submitted that of all the severance cases, Conran is the only one which deals with a factual situation analogous to that in the present case, and that it supports this taxpayer's position.

The Government, however, seeks to extract from the interest cases and the severance cases the conclusion that, if the taxing authorities may treat interest on an award, as a separate item and severance damage to property not taken, as a separate item, they have general authority, in disregard of State law, to dissect all condemnation awards in accordance with the various factors which were considered in arriving at the amount awarded, and having done so, to assign a monetary value to each factor and to exclude some of them from nonrecognition of capital gain.

The District Court, in the present case, declined to adopt this conclusion, but stated, instead, that these authorities

> "stand for the proposition that expenses which are separate from the fair market value of the land may be taxed as ordinary income."

Appendix, p. 20 (Emphasis in Original)

Interest on an overdue award, may properly be considered a separate item from the award. Severance damages to land not taken, may, if this Court decides to depart from its decision in Lapham, be considered a separate item from the award for what was taken. Nevertheless, where the State law prescribes moving expenses as a factor to be considered in computing the amount of an

award, that factor is not to be considered as creating a separate award.

National Publishing Company v. Commissioner, 24 T C M 1470 (1965)

C. Kendall v. Commissioner, 31 T.C. 549 (1958)

III

EVEN IF THE COURT CONCLUDES THAT THE AWARD IS SEPARABLE, THE AMOUNT RECEIVED FOR MOVING EXPENSES IS STILL PART OF "THE AMOUNT REALIZED UPON SUCH CONVERSION" AND ENTITLED TO NONRECOGNITION OF GAIN.

The Internal Revenue Code provides that, on an involuntary conversion in which the taxpayer's property is involuntarily converted into money, if the taxpayer purchases other property similar or related in service or use to the property converted, gain shall be recognized only to the extent that "the amount realized upon such conversion" exceeds the cost of the replacement property.

26 U.S.C. Sec. 1033 (a)(3)(A)

Appellant's Brief, p. 14

This or a similar provision has been included in every Internal Revenue Act and Code since 1921.

Revenue Act of 1921 Sec. 234 (a)(14)

It's purpose has been held to be to relieve the hardship which would result if a taxpayer were required to pay a capital gains tax when his property is involuntarily converted into money and he expends the proceeds to acquire replacement property for what has been taken from him.

John Richard Corp. v. Commissioner, 46 T.C. 44 (1966)

Conran v. United States, 322 F. Supp. 1055 at 1057. (D.C. E.D. Mo. 1971)

If the statute is to be construed to achieve the purpose of Congress in

enacting it, the phrase "the Amount realized upon such conversion" must be taken to include all of the money which came into the taxpayer's possession as a consequence of the taking of his property. This is apparently what prompted this Court to refuse to separate "severance damages" in Lapham.

> "because what the seller actually received is what he has realized on the disposal of it (the land) by sale"
>
> Lapham v. United States, 178 F(2d) 994 at 996, (C.A. 2d. 1950)

This construction of the statute would permit the Court to separate "severance damages" from the award where this is to the taxpayer's advantage, as was true in Johnston and Vaira and still consider such damages to be a part of the amount realized upon the involuntary conversion, as was done in Conran.

In the present case, whether or not the Court finds the portion of the award attributable to consideration of moving expenses as severable from the award, the entire award should be considered as the amount realized upon the conversion and so eligible for nonrecognition of capital gain.

CONCLUSION

THE JUDGMENT OF THE DISTRICT COURT SHOULD BE AFFIRMED.

Respectfully submitted,

CAMP, WILLIAMS and RICHARDSON

By _____
Edward B. Scott

Attorneys for Appellee
130 West Main Street
New Britain, Connecticut 06050

CERTIFICATE OF SERVICE

It is hereby certified that service of this brief was made the 4th day of December, 1974, upon opposing counsel by depositing four copies thereof in the United States mail, postage prepaid addressed to

Scott P. Crampton, Esq.
Assistant Attorney General
Gilbert E. Andrews, Esq.
William A. Friedlander, Esq.
Richard Farber, Esq.
Attorneys, Tax Division
Department of Justice
Washington, D. C. 20530

Peter C. Dorsey, Esq.
United States Attorney
915 Lafayette Boulevard
Bridgeport, Connecticut 06603

Edward B. Scott
Attorney